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September 6, 2002

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**Memorandum of Ex Parte Presentation**

SEP - 6 2002

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Marlene H. Dortch, Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

Re: CC Docket No. 01-338, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers;  
CC Docket No. 96-98, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; and  
CC Docket No. 98-147, Deployment of Wireline Services Offering Advanced Telecommunications Capability

Dear Ms. Dortch:


On September 5, 2002, Edward Whitacre, Chairman and Chief Executive Officer, William Daley, President; Randall Stephenson, Senior Executive Vice President and Chief Financial Officer; James D. Ellis, Senior Executive Vice President and General Counsel; and James C. Smith, Senior Vice President, representing SBC Telecommunications, Inc., met with Chairman Michael Powell; Marsha MacBride, FCC Chief of Staff; and Christopher Libertelli, Chairman Powell's Legal Advisor for Wireline Competition.

The purpose of the meeting was to discuss issues associated with the financial and investment impacts of the UNE Platform. The attached material was discussed during the course of the meeting.

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Please contact the undersigned at (202) 326-8847 should you have any questions.

Sincerely,

Brian Benison 

Attachment

cc: Chairman Powell  
M. MacBride  
C. Libertelli

# **UNE-P: Impacts and Implications**

Prepared for the  
Federal Communications Commission



SBC Communications Inc.

# **Agenda**

**Overview**

**Ed Whitacre**

**Financial Review**

**Randall Stephenson**

- \* Financial Trends
- \* UNE-P Impacts

**Summary**

**Bill Daley**

# Overview

Ed Whitacre  
Chairman and Chief Executive Officer  
SBC Communications Inc.

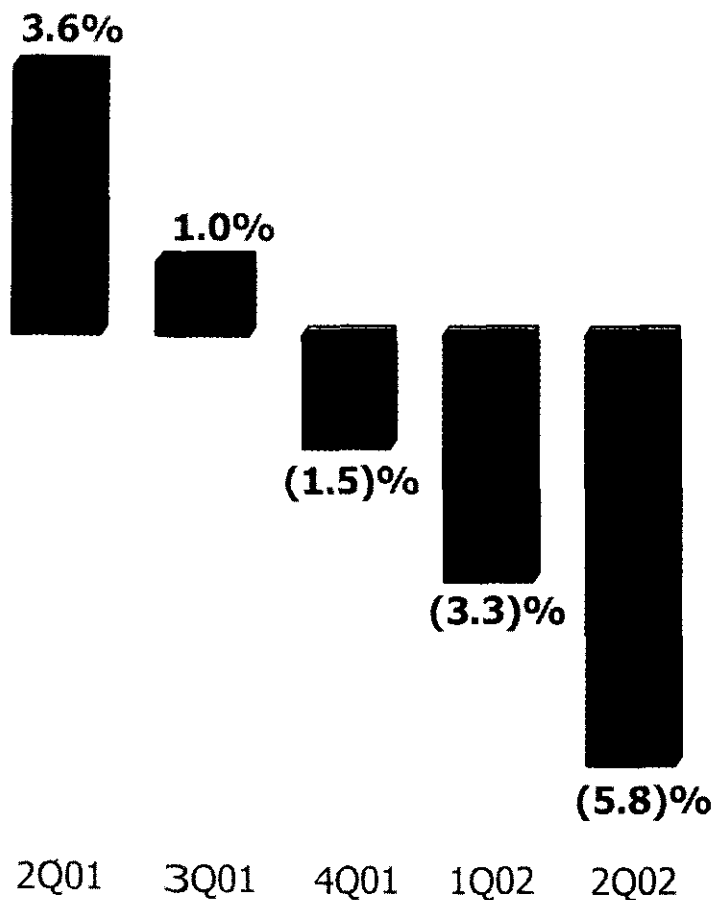
# Financial Review

- **Financial Trends**
- UNE-P Impacts

Randall Stephenson  
Chief Financial Officer  
SBC Communications Inc.

# Wireline Revenues

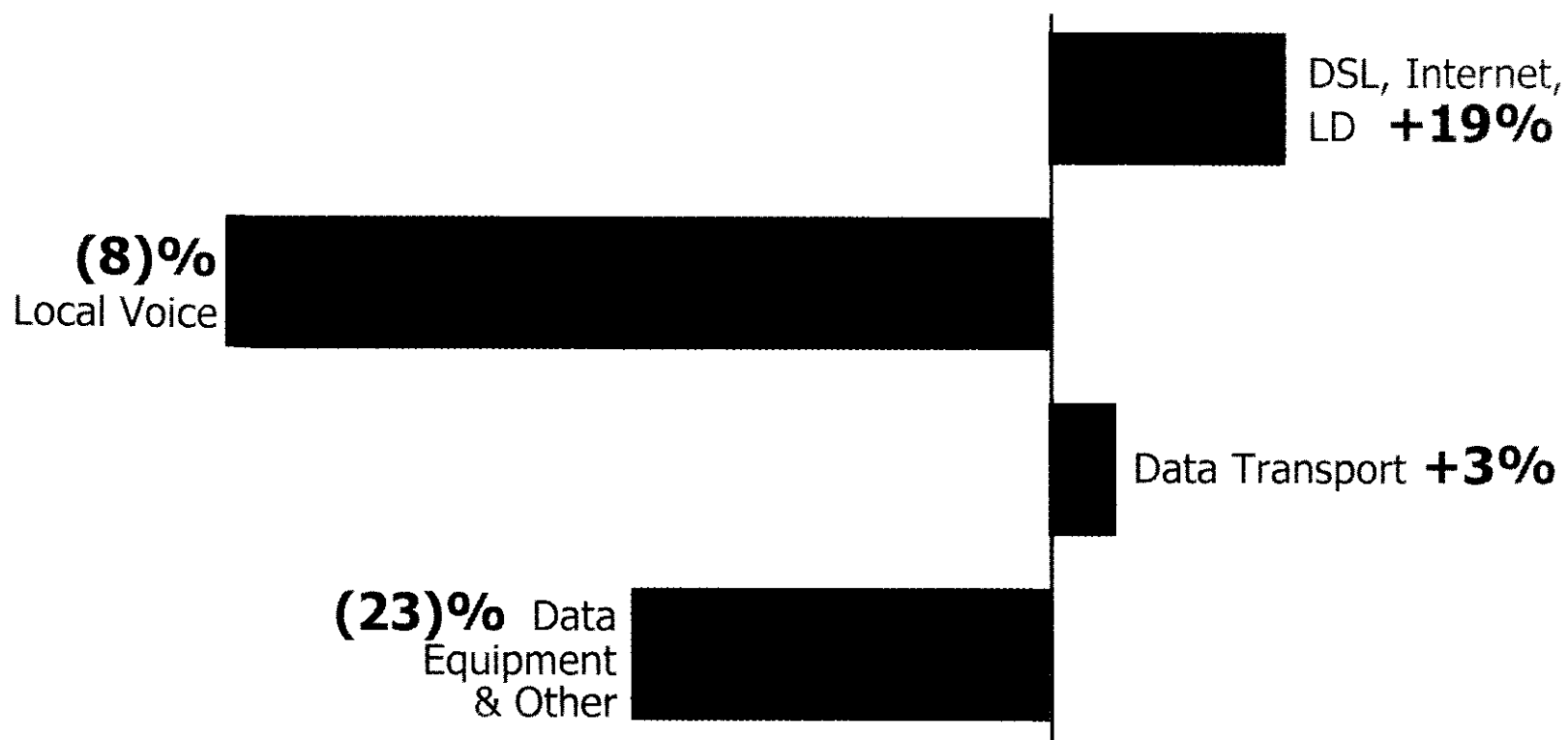
**SBC Wireline Revenues,  
YOY Growth Rates**



- Down more than \$1 billion over the past three quarters.
- More than half of that loss came in the most recent quarter.
- Assuming annual revenue declines continue at current pace (5.8)% -- no further acceleration -- over the next four quarters, we will lose another \$2.3 billion from our wireline revenue stream.

# Local Voice Driving Revenue Decline

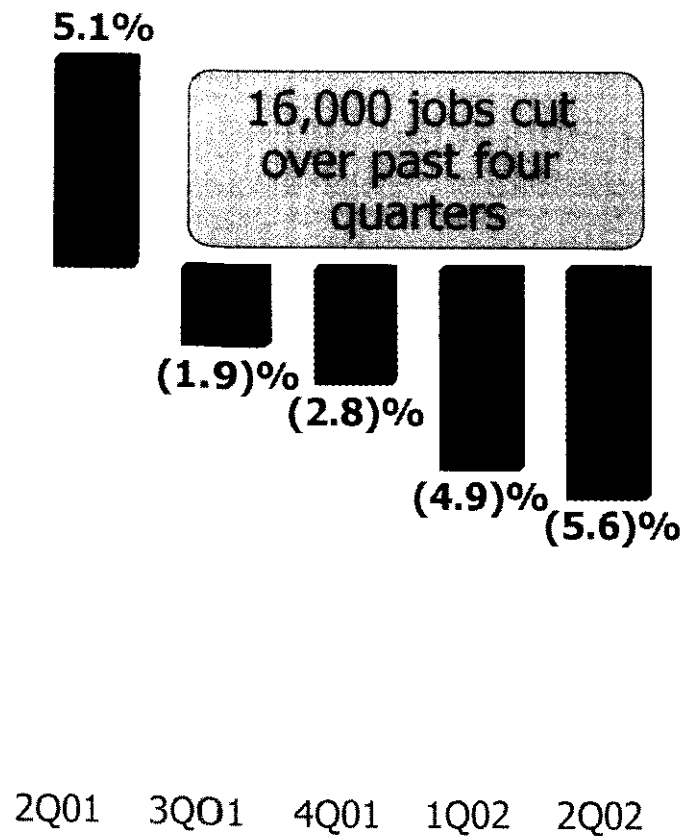
2Q02/2Q01 Changes By Product Group



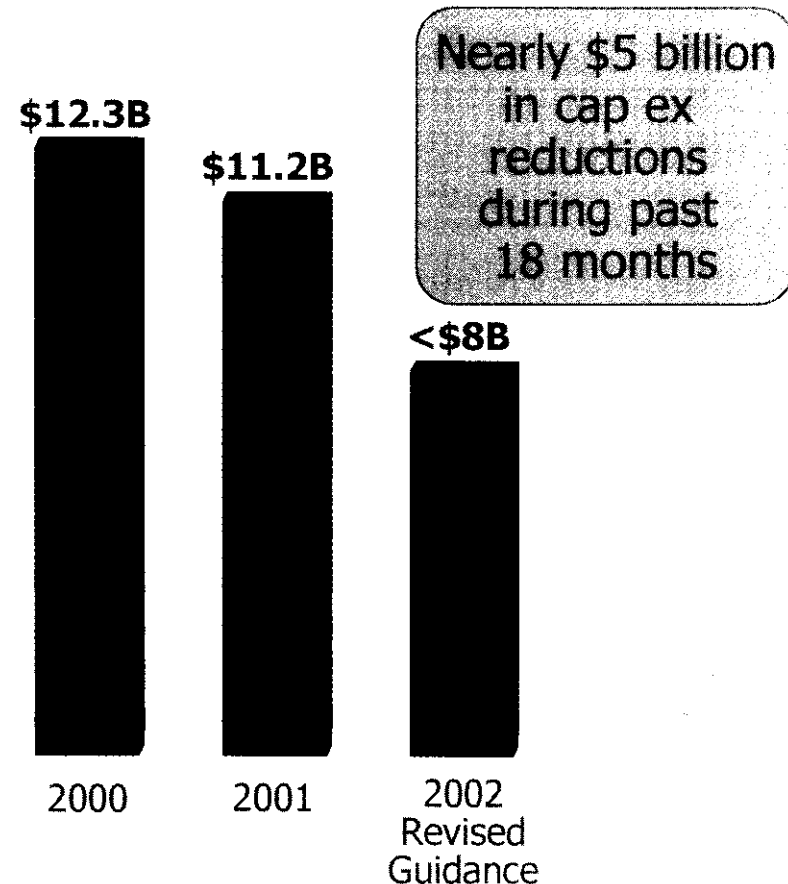


# Cutbacks in Jobs and Investment

**SBC Wireline Cash Operating Expenses,  
YOY Growth Rates**



**SBC Annual Capital Investment**



# A Shrinking Business

## SBC Wireline Results

2Q02/2Q01

Revenues	(5.8)%
Cash Operating Expenses	(5.6)%
Depreciation & Amortization	1.2%
Operating Income	(12.6)%
Capital Investment	(41)%

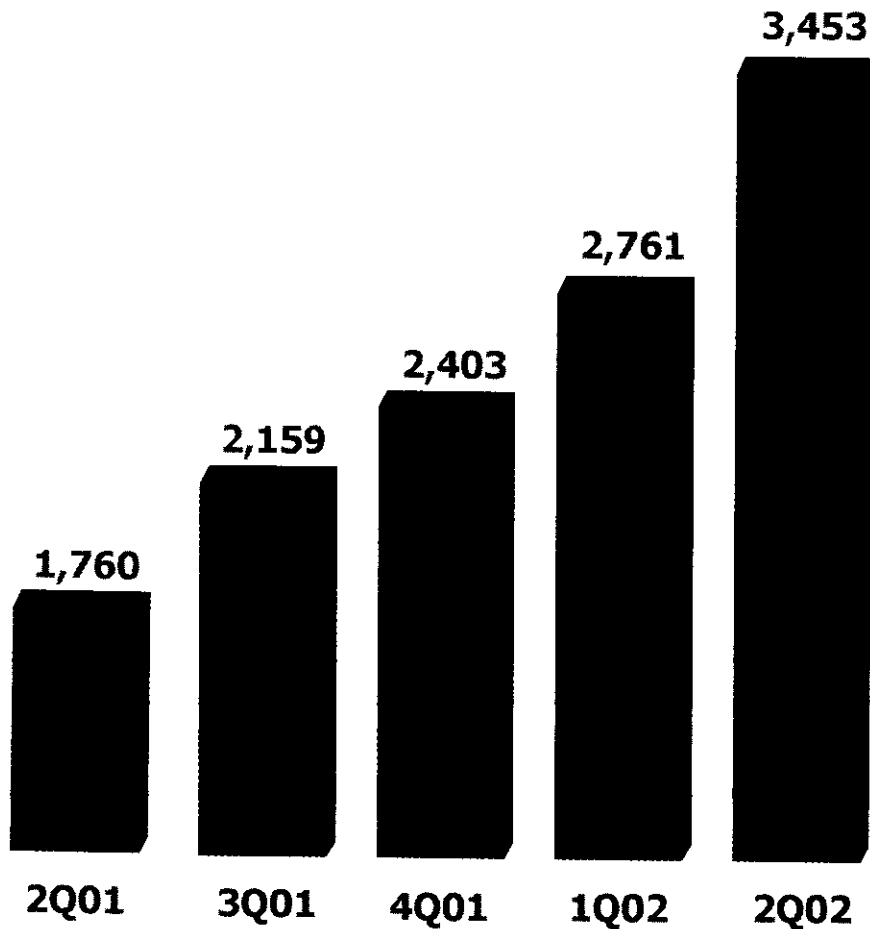
# Financial Review

- Financial Trends
- **UNE-P Impacts**

Randall Stephenson  
Chief Financial Officer  
SBC Communications Inc.

# UNE-P Adoption

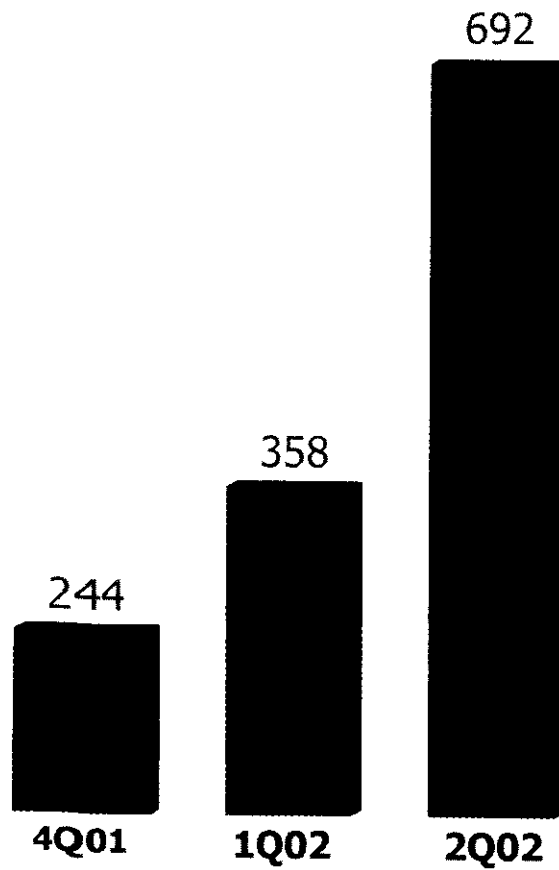
**SBC UNE-P Lines In Service**  
**2Q 2002**  
(in thousands)



- Over the past year, UNE-P lines in service have doubled.
- We have lost 3.5 million lines... nearly equivalent to losing the state of Ohio.
- SBC still has 1 million resale lines likely to be converted to UNE-P.
- SBC's market share is currently 85%. Projected to be 66% by end of 2003.

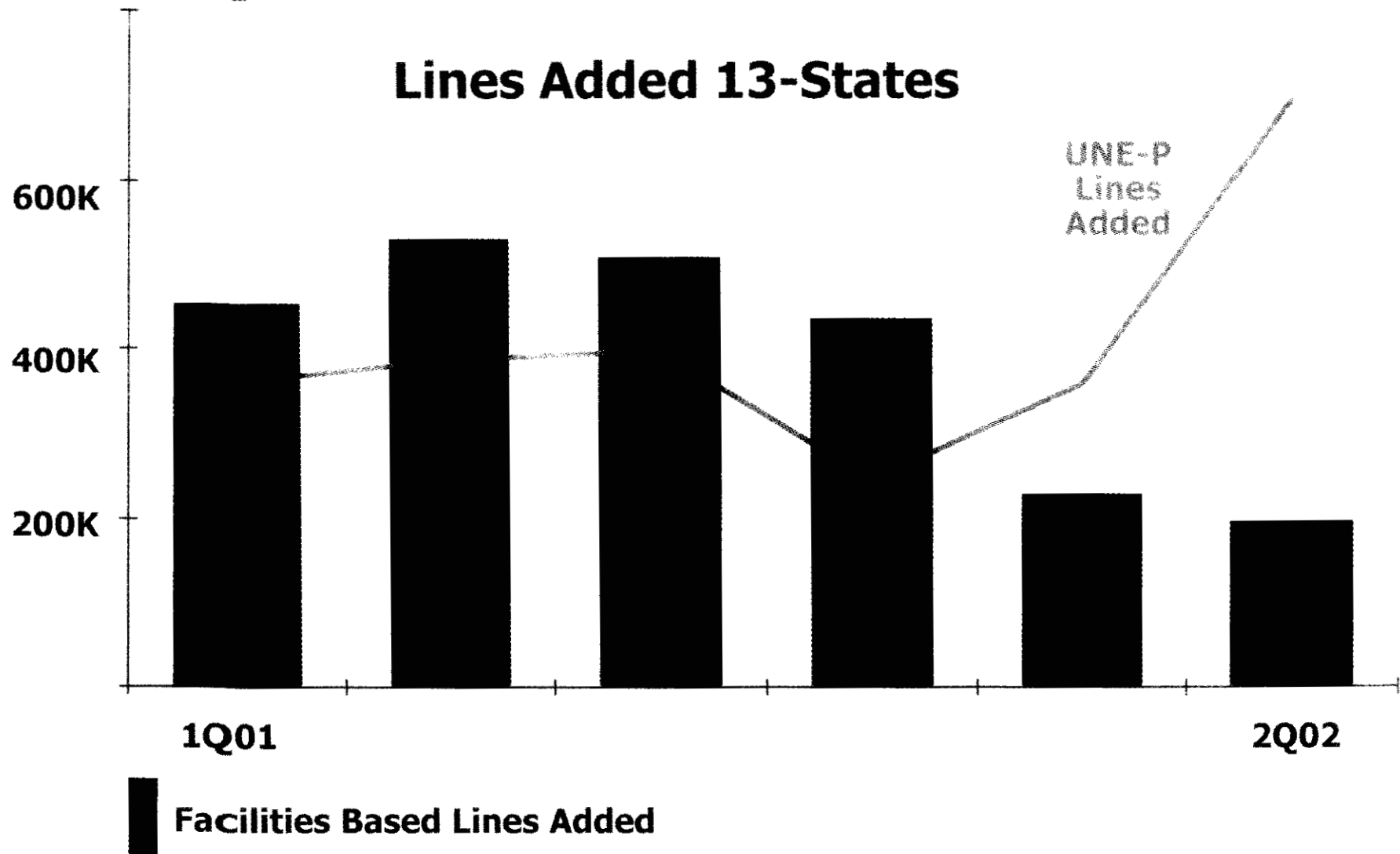
# UNE-P Acceleration

**SBC UNE-P Lines Added  
Per Quarter – 13 States**  
(in thousands)

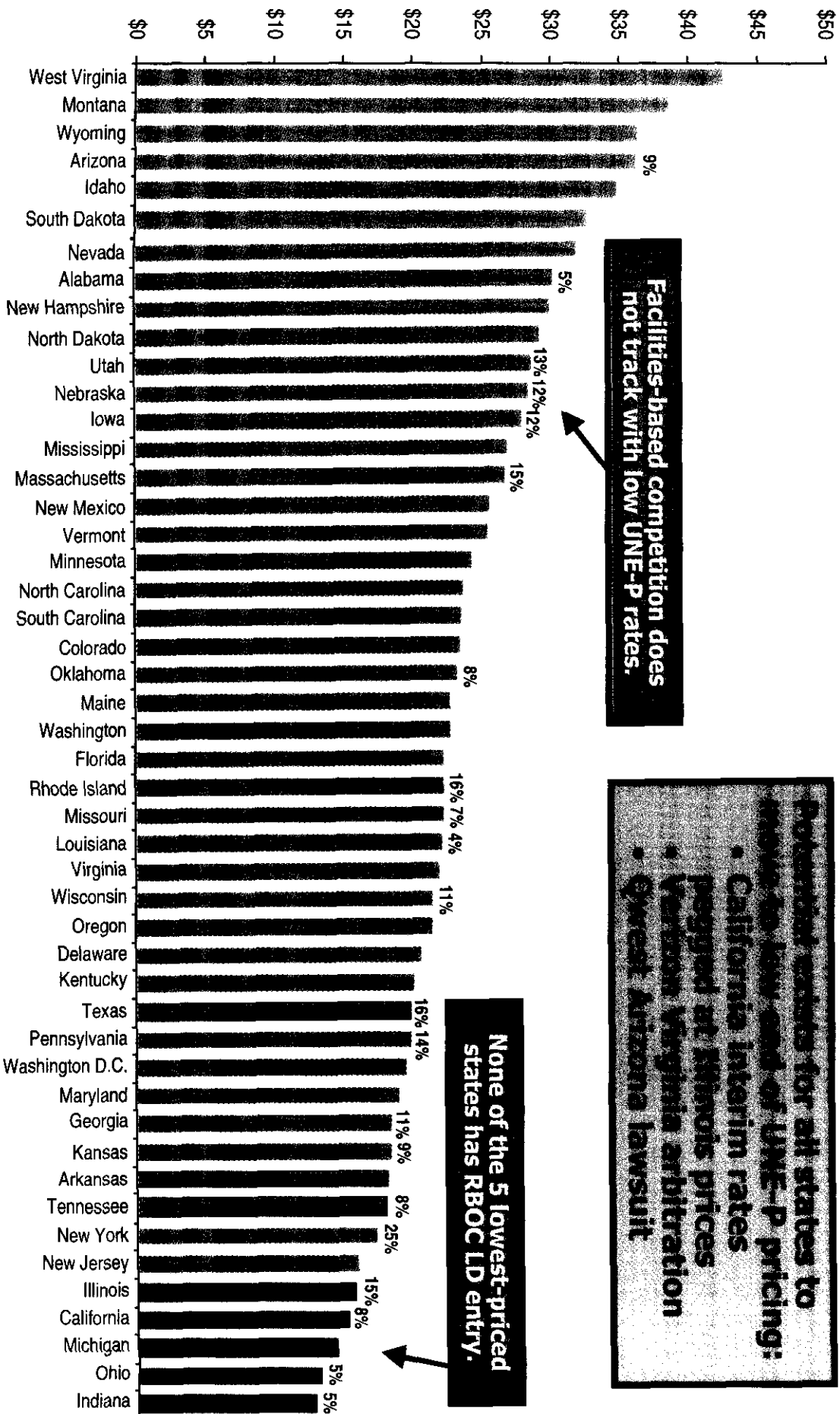


- SBC loses 12,000 lines per day to UNE-P. Projected to be 29,000 per day by end of 2003.
- UNE-P lines added in 2Q02 were more than 70% greater than any previous quarter.
- As states have dropped prices, facilities-based competition has lagged and UNE-P has become the dominant means to compete with SBC.

# Competition Trends

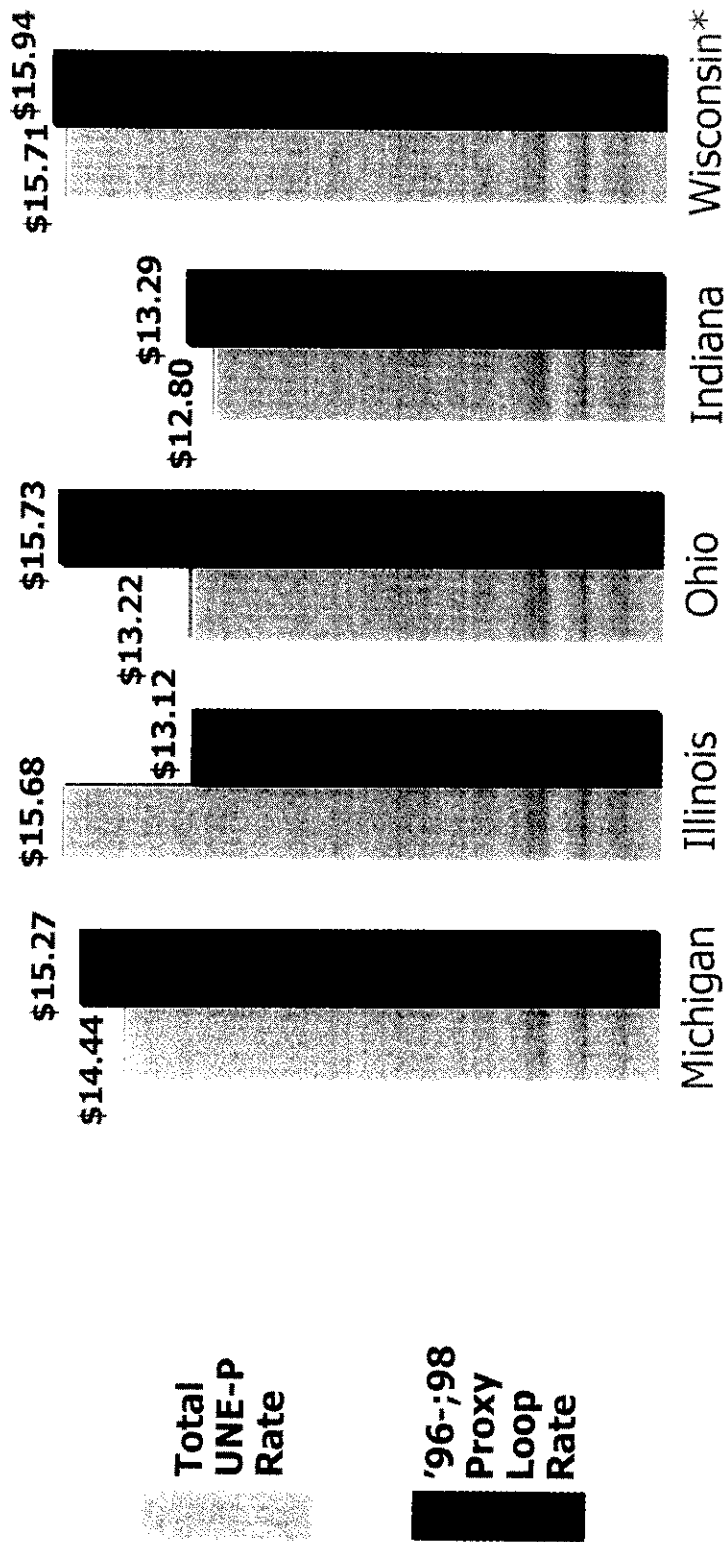


# The Five Lowest-Priced UNE-P States Are All SBC Markets



Percentage of end-user switched access line served by reporting competitive local exchange carriers source: FCC Industry Analysis Division Common Carrier Bureau, "Local Telephone Competition: Status as of December 31, 2001"

# UNE-P Rates vs FCC Proxy Loop Rates



\* Estimated impact of pending order.



# IXCs Exploit Very Large UNE-P Discounts

	Total Recurring UNE-P Rate*	Discount From Retail Residential	Below Non-SBC National Ave
<b>Illinois</b>	\$15.68	55%	39%
<b>Michigan</b>	\$14.44	63%	44%
<b>Ohio</b>	\$13.22	57%	48%
<b>Indiana</b>	\$12.80	62%	50%
<b>California</b>	\$15.24	47%	40%
<b>Wisconsin**</b>	\$15.71	48%	39%

**All have  
recently  
ordered  
lower prices**

\* Per Anna Marie Kovacs of Commerce Capital Markets, Inc. May report on UNE-P adjusted to reflect only recurring rates and recent rate changes.

\*\* Estimated impact of pending order.

# Simple Margin Transfer With No Investment

## Ameritech Consumer 5-State Averages

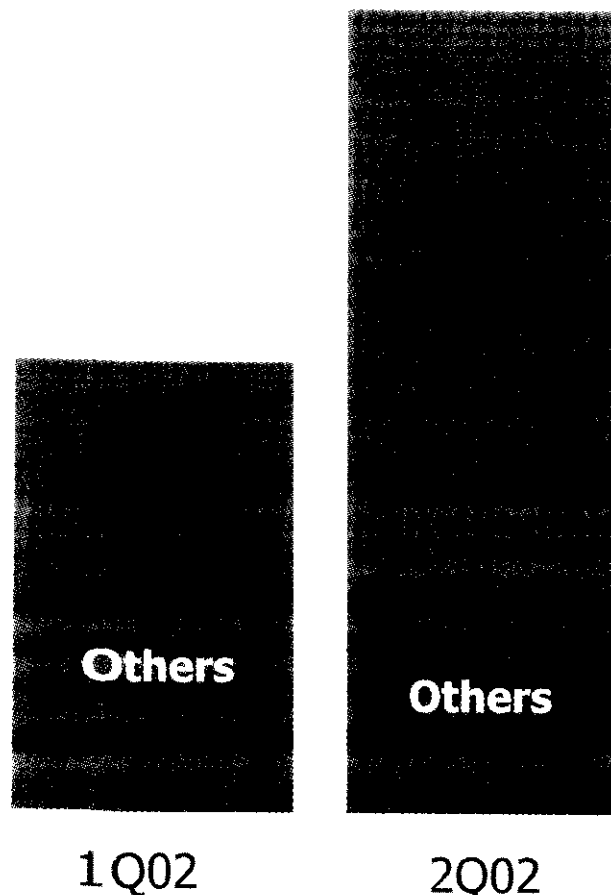
	<u>SBC Retail</u>	<u>SBC UNE-P</u>	<u>IXC Using SBC UNE-P</u>
Revenue	\$36	\$15	\$41
Expenses	*\$26	*\$26	**\$23
Operating Margin	\$10	\$(11)	\$18
Capital Investment	\$1,100	\$1,100	\$0
<i>Capital Investment</i>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
<i>Service Quality</i>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
<i>Regulated</i>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
<i>Universal Service Provider</i>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>

\* Excludes cost associated with data services.

\*\* UNE-P plus 20% SG&A.

# UNE-P Predominantly Used by the Two Largest IXC's

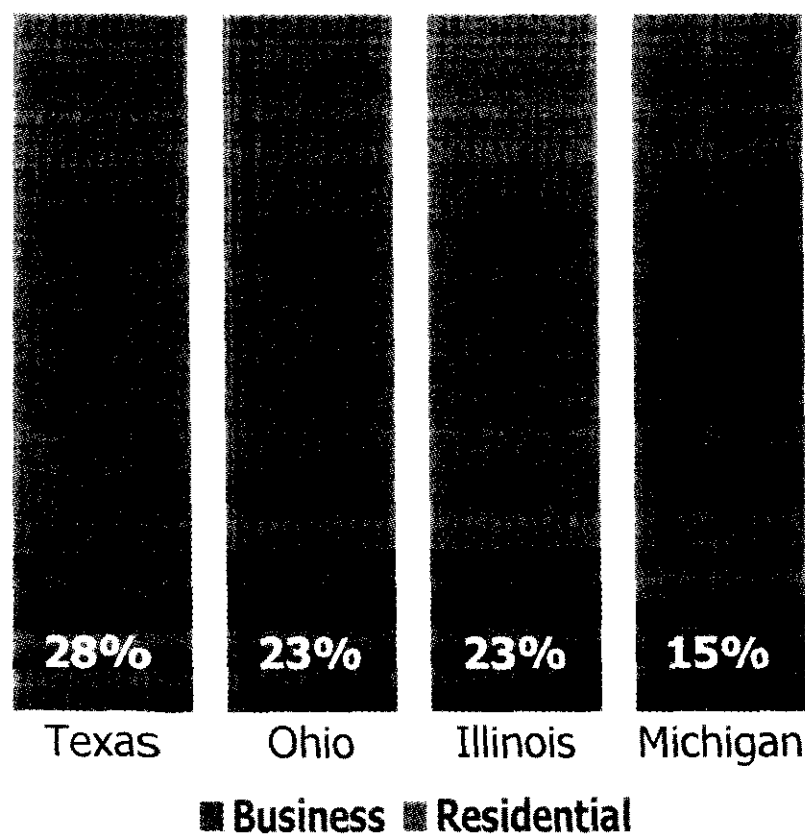
**SBC UNE-P Lines  
Added Per Quarter**



- More than 70% of SBC's UNE-P lines added in 2Q02 were for the two largest IXC's.
- From 1Q02 to 2Q02, UNE-P lines added for AT&T and WorldCom/MCI tripled while UNE-Ps added for others actually declined.
- WorldCom receivables to SBC and its affiliates have grown to more than \$400 million.

# Dominant Use of UNE-P: To Target Residential Customers

**SBC UNE-P Lines In Service  
SBC's Four Largest UNE-P States**



- Across SBC's 13 states, more than 70% of all UNE-P lines are residential.
- In SBC's four largest UNE-P states, which have been targeted most aggressively by the large IXC's, residential customers represent an even higher percentage of total UNE-Ps.

# IXC Lead Offers

(Ameritech states)

## AT&T

- **Pricing: \$52.57 \***
- **Local Service**
  - Access line
  - Calling features (3)
- **Long Distance**
  - Unlimited to other AT&T residential consumers

## MCI/WCOM

- **Pricing: \$49.99 \***
- **Local Service**
  - Access line
  - Calling features (5)
- **Long Distance**
  - Unlimited long distance calling

\* Pricing includes interLATA long distance but excludes Subscriber Line Charge and other miscellaneous taxes and fees.

Source: Company's website

- MCI's offer is their lead offering "Neighborhood Complete" at \$49.99
- AT&T's offer includes their lead local "Call Plan Unlimited with 3 Feature Package Enhanced" at \$29.95-34.95 and their long distance offer "Unlimited Plan" at \$19.95. Offered in IL, OH and MI.

# SBC Provides Residential Universal Service While IXC's "Cherry Pick" Profits

IXC offers target premium customers rather than universal service.

## Ameritech Residential Customer Spending

		Ave Rev per Line	% of Total SBC Revenue	% of Total SBC Profit
IXCs	Quartile 1	\$43-\$54	36%	72%
	Quartile 2	\$36-\$43	29%	41%
SBC	Quartile 3	\$24-\$36	21%	9%
	Quartile 4	\$0-\$24	14%	(22)%

**SBC's resulting customer base will be unprofitable, with no funds for investment.**

# Clear IXC Strategy

## No Capital Investment

**"... gives AT&T Consumer unmatched leverage to create offers ... without making economic sacrifices."**

*Betsy Bernard,  
President, AT&T Consumer*

**"We're profitable everywhere we sell because we limit ... where we sell based on cost.... [W]e're deploying very little capital to make it work."**

*Wayne Huyard  
COO, MCI*

**"We do not expect that the growth of our business will require the levels of capital investment in fiber optics**

**and switches that existed in historical telecommunications facilities-based models."**

*10-Q Filing  
Z-Tel*

## High Margins, Low Risk

**"Our principle of maximizing cash requires that we only enter states that meet our gross margin requirements."**

**"We are not going into states where we don't have a gross margin of 45% on the local ...."**

*Betsy Bernard,  
President, AT&T Consumer*

# Capital Market Reaction

## Stock Prices

	Before UBS Warburg Report (08/19/02)	After UBS Warburg Report (08/23/02)	Percent Change
SBC	\$29.87	\$26.30	(12.0)%
AT&T	\$10.76	\$12.22	13.6%

**"We believe SBC has the most attractive region for UNE-P providers. SBC takes the hardest hit for each retail line lost to UNE-P competitors ... SBC has lost more retail lines to UNE-P than any other Bell, at 3.45 million... [and we] expect SBC to lose 1 million retail lines to UNE-P in the third quarter of 2002."**

**- UBS Warburg**



# Summary

**Bill Daley  
President  
SBC Communications Inc.**

# Impacts

- **Reduced Service Quality**
- **Reduced Ability to Provide Service to all Customers**
- **No Incentive To Invest in Networks**
- **Eliminated Jobs**
- **Slower Deployment of New Services**
- **Increased Cost of Capital**
- **Weakened Equipment Suppliers**

# **Next Steps**

- **Current regulatory regime regarding UNE-P and pricing is unsustainable**
- **Turmoil in industry calls for quick and decisive action**
- **As long as we have carrier of last resort obligations, prices must be set to recover our costs**
- **There are many ways to solve this problem, but time is extremely short. Whatever direction the FCC moves, it must be effective in a very short period of time**